UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF NEW YORK

In re:	:	
		Case #19-23013-rdd
53 STANHOPE LLC	:	
		300 Quarropas Street
	:	White Plains, New York
For Chapter 11		
	:	December 17, 2020
		4:17 p.m.
----------	:	
		TELEPHONE CONFERENCE

TRANSCRIPT OF BENCH RULING ON CONFIRMATION OF THE DEBTOR'S AMENDED PLAN (RELATED DOCUMENT #93) VIA COURT SOLUTIONS
BEFORE JUDGE ROBERT D. DRAIN
UNITED STATES BANKRUPTCY COURT JUDGE

APPEARANCES:

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Proceedings recorded by electronic sound recording;
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E X A M I N A T I O N S

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E X H I B I T S

Exhibit Number	Description	ID	In	Voir Dire
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(Proceedings commence at 4:17 p.m.)

THE COURT: All right, I think those that have joined the call for the In re: 53 Stanhope cases understand why I moved the call that I originally thought would be at 2:30 to 4. I think we're all on the phone at this point. I see Ms. Recine from the Kasowitz firm, Mr. Frankel, Ms. Pena, Ms. Caruso, Mr. Glenn, okay, and I told you all that I would giving you a bench ruling following the trial that took place this summer on two related issues. First, the debtor's request for confirmation of their Chapter 11 plan, and relatedly the debtor's objection to a substantial portion of the proofs of claim filed by Brooklyn Lender in these cases. Those are related issues because the plan would not be feasible if the Brooklyn Lender claims were allowed in the full amount sought and, frankly, allowed in potentially lesser amounts but greater than the amount that the debtor contends should be the allowed amount in the claim.

The plan also sought a determination that the claims of the so-called Israeli investors, which comprise claims both of what I refer to as investor LLCs against the debtor's potential interests of the investor LLCs in four of debtors, and claims by individual investors, i.e. people who invested in the investor LLCs against all of the debtors, should be subordinated under Section 510(B) of the

Bankruptcy Code, which is how they were to be treated under the plan in Class 6 of the plan.

I, of course, would have preferred to have given you a written decision on the issues that were raised, but given my calendar and given my belief that the parties need a ruling promptly one way or the other on these issues, I'm instead going to give you a fairly lengthy bench ruling. When I give such a ruling, I reserve the right to go over the transcript and correct it not only for typos of citations that the court reporter didn't put in the correct citation format, but also for content to the extent I believe I said something ungrammatically, wanted to supplement what I said, or the like. My rulings won't change but if I do make those types of changes, I will file a modified bench ruling, which is not at that point a transcript, but rather a ruling.

Before I get into the ruling, itself, I just want to confirm that you are not going to be wasting the next roughly hour and a half. Mr. Frankel, are the debtors still looking to confirm the Chapter 11 firm?

MR. MARK FRANKEL: Yes, Judge, and we have an extension on the financing to February 1.

THE COURT: Okay, very well. All right, so let me give you my ruling. The Chapter 11 plan proposes to finance the debtor's exist from Chapter 11 with an exit loan from an

entity known as Lightstone Capital. The exit loan would be in itself sufficient to pay in full and in cash the estimated allowed claims of the debtor's secured lender, Brooklyn Lender, LLC, in the debtors contend the allowed amount of roughly $35.3 million. After paying allowed administrative expenses, and general unsecured claims that would be paid in full in cash, as well, and without any payment in cash in respect of the Israeli investor claims, the exit financing would have a little under $2 million left over. The debtors acknowledge that in each of their estates Brooklyn Lender is over secured and, therefore, under Section 506(B) of the Bankruptcy Code, it would have an entitlement, not only the payment of post-petition interest, but also its reasonable attorneys' fees as provided for in the various loan agreements that the debtors have with a different lender, a successor to the original lender, Signature Bank.

The debtors assume that some portion of the excess over the allowed claims that would be paid in full in cash would go to pay the allowed additional portion of Brooklyn Lender's attorneys' fees claim, with potentially some surplus left over for interest payments going forward.

The plan has been objected to and the debtor's claim objections have been objected to by Brooklyn

Lender and the Israeli investors, respectively. The objection to the Brooklyn Lender claims was the subject of the trial that the Court held this summer in July and August. The Israeli investors and the debtors determined not to litigate the merits of the claims asserted by the Israeli investors, with the exception of the plan's treatment of those claims as being subject to mandatory subordination under Section 510(B) of the Bankruptcy Code.

The plan is an unimpaired plan. That is, it provides for cash payment in full of the (indiscernible) claims against the debtor's estate, and relies upon Section 1124(1) of the Code for its contention that such payment in full renders the claimants unimpaired, and consistent with Section 1126 of the Code means that they are deemed to incent the plan. And that is Section 1126 down to F of the Code.

Section 1124(1) provides that a claim is impaired unless the plan leaves unaltered the legal equitable and contractual rights to which such claim or interest entitles the holder of such claim or interest. As I said, if, however, the allowed amount of the Brooklyn Lender claims exceeds the cushion under the exit financing, the debtors, I believe, concede that the plan would not be feasible under

Section 1129(A)(11) really just getting out of the gate since the cash would not be sufficient to leave Brooklyn Lender unimpaired, it would be owed more money, in other words.

Similarly, even if Brooklyn Lender's allowed claims are in the amounts asserted by the debtors or within the $2 million excess cap under the exit financing, if the Israeli investors' claims are not subordinated under Section 510(B) and/or the Court concludes that not being subordinated those claims would be in excess of the $2 million cap, the plan also wouldn't be confirmed because, again, those claims are said to be unimpaired as claims under the debtor's plan.

I will address first the issues raised with respect to the claim objection to Brooklyn Lender's claims and turn to the Israeli investors. The point has been alluded to but I should reinforce it, although this is a joint plan for many debtors, the plan is, in effect, a separate plan for each debtor. Each debtor deals with its own creditors and interest holders under the plan, and the plan is not a substantive consolidation.

That being said, the documents at issue are basically standard when one deals with Brooklyn

Lender's claims against each debtor. There's a substantially similar note and mortgage with respect to each loan. The fundamental dispute between the debtors and Brooklyn Lender is over the interest component with respect to each loan, both with respect to Brooklyn Lender's claim for pre-bankruptcy or pre-petition interest and it's claims for post-petition, or sometimes referred to as pendency interest, i.e. interest accruing after the petition date and before confirmation and the effective date of the plan.

The bankruptcy code and case law addresses those claims differently. One looks to state law to determine a creditor's claim for pre-petition interest. *Key Bank National Association v. Milham* (*In Re: Milham)*, 141 F3d 420-423 (2d Cir. 2011) and *In Re: Residential Capital LLC,* 508 B.R. 851, 858 (Bankr. S.D.N.Y. 2014). New York Courts, and the law of New York governs here given the location of the properties and the parties, will enforce unambiguous contract provisions for post-default interest at a higher rate than pre-default interest, generally.

Pereira v. Prompt Mortgage Providers of North America, LLC, (In Re: Heavey), 608 B.R. 341, 348-49 (Bankr. E.D.N.Y. 2019), and the cases cited therein. In that case, as here, the post-default interest rate

was 24 percent. Here the pre-petition rate varies among the debtors, but is generally somewhere between 3.625 percent and 4.35 percent. See also *In Re: Campbell,* 513 B.R. 846, 850 (Bankr. S.D.N.Y. 2014), also dealing with the 24 percent post-default rate on a pre-petition basis.

Of course, there has to be a proper default under the parties' contracts for a post-default rate to be owed, see *In Re: Northwest Airlines Corp.*, 2007 Bankr. LEXIS 3919 at *5 (Bankr. S.D.N.Y. Nov. 9, 2007). Moreover, under New York law there are certain circumstances, not worded as appropriate, for a Court to refrain from enforcing a loan contract, as noted by the *Heavey* Court's 608 B.R. 349 and the cases cited therein. And here the debtors have raised both of those defenses to pre-petition contract rate default interest at 24 percent.

I will note, however, that if, in fact, I do not accept those defenses, the loan agreements are clear and I believe the debtors have conceded that post-default interest under the loan agreement begins to run from the date of the default rather than date of the noticing of the default.

As noted by Brooklyn Lender in its submissions to the Court, since certain of the defaults that it

has asserted here would, if enforceable, relate back to the initial issuance of each loan, the accrual of the additional interest at the post-default rate would nearly double the amount of the claim at issue. In fact, slightly more than double the amount of the claim.

Post-petition interest, or pendency interest, is governed by the Bankruptcy Code. First, Section 502(B)(2) of the Bankruptcy Code disallows claims for unmatured interest, i.e. post-petition interest, though the Courts have recognized an exception to that statutory provision based on various theories for unsecured creditors. Namely either under Section 1129(A)(7), the best interest test, since a Chapter 7 case waterfall distribution scheme includes, at a lower priority, payment of post-petition interest at the legal rate. Or alternatively, under the fair and equitable test of section 1129(B), or a general equitable exception as laid out in the case law, which states that for solvent debtors, before any return to the debtor's interest holders, they should receive post-petition interest at a rate to be determined by the Court.

In addition, in Section 506(B) of the Bankruptcy Code, (indiscernible) provides that to the

extent that an allowed secured claim is secured by property, the value of which after any recovery under Subsection C of this section, which is relevant here, is greater than the amount of such claim, there shall be allowed to the holder of such claim interest on such claim and any reasonable fees, costs or charges provided for in the agreement or state statute under which such claim arose.

It is well established that Section 506(B) does not require interest for an over secured creditor to be paid at any particular rate. The grammar of that section means that the rate of interest is within the limited discretion of the Court. *In Re: Milham,* 141 F3d at 423 or, as Judge McMahon held in *In Re: 139-41 Owners Corp.*, 313 B.R. 364-368, at the sole discretion of the Court, (S.D.N.Y. 2004).

However, there is a presumption, and in a number of cases it's stated to be a strong presumption, that the contract rate will apply subject to equitable considerations. Whether that contract rate includes default interest of just contract interest is less clear in the case law. See generally *In Re: Heavey,* 608 B.R. 353, *In Re: 1111 Myrtle Avenue Group, LLC,* 408 B.R. 729, 736 (Bankr. S.D.N.Y. 2019), and *In Re: General Growth Properties, Inc.*, 451 B.R.

323, 326 (Bankr. S.D.N.Y. 2011).

I noted earlier that the plan provides here for unimpairment under Section 1121, I'm sorry, 1124(1) of the Bankruptcy Code. That section has been interpreted by the Courts, including specifically on this issue by the 5th Circuit, to be subject to the requirements of the Bankruptcy Code as it pertains, as they pertain to the allowability of a claim. Namely, although the section states that a claim is impaired unless the plan leaves unaltered the legal equitable and contractual rights to which such claim or interest entitles the holder of such claim or interest, the congress contemplated that those rights include the limitations on them imposed by the Bankruptcy Code's own limitations on claim allowance. Including limitations on the allowance of post-petition interest. See *In Re: Ultra Petroleum Corp.*, 943 F.3d 758, 763-65 (5th Cir. 2019) and the cases cited therein, including *In Re: PPI Enterprises USA, Inc.*, 324 F.3d 192, 201-02 (3rd Cir. 2003).

Having written the legislative history to the amendment to that section, which was intended to reverse the case that had provided for unimpairment of a claim of an unsecured creditor of a solvent debtor, I was surprised by that holding of *Ultra Petroleum*,

but I accept its logic having considered its discussion of the legislative history generally and the operation of the statute. So, therefore, I do not believe that Section 1124 eliminates consideration of the factors that Courts consider when they decide whether to apply a contract rate under Section 506(B) or not.

Those factors are well established at this point. It is also generally recognized that they are to be used sparingly given the importance of predictability with respect to secured loan transactions in bankruptcy. See *In Re: Residential Capital,* 508 B.R. at 851. Those factors to be considered, separate and of course apart from the state law factors for pre-bankruptcy interest which would continue in a bankruptcy case, as well, are the following: The solvency of a debtor's estate; whether the default rate of interest is considered a penalty; if there has been creditor misconduct; if avoiding -- I'm sorry, if recording the creditor interest at the default rate would harm other creditors; and lastly, the adverse effect of allowing the interest at the default rate on the debtor's fresh start. Again, see *In Re: Heavey,* 608 B.R. at 353, and *1111 Myrtle Avenue Group, LLC,* 736.

None of those factors is dispositive, it's decided on a fact by fact and case by case basis, including whether the debtor is solvent and/or unsecured creditors would be harmed by the payment of interest at the default rate, although that is an important factor. Generally where it has been applied to require a default rate of interest, the plan has either already been confirmed or there is no real risk of insolvency. And, further, there has been no creditor misconduct, and it appears likely that the debtor will be able to confirm a Chapter 11 plan. See, for example, *In Re: 1111 Myrtle Avenue,* 598 B.R. at 741, as well as at 738. And *In Re: General Growth Properties, Inc.,* 451 B.R. at 330, 331, where Judge Gropper found that the debtor was highly solvent and there was no risk, for starters, the plan had already been confirmed and (indiscernible) effective.

As far as whether the default rate would be considered a penalty, as I noted the significant spread, as is the case here, between non-default and default interest has often been held not to be non-enforceable or a penalty at all. Again, see *In Re: Heavey*, as I previously cited, and the cases cited therein, where a spread of, in those cases, 18.625 percent, 12 percent or 8.8 percent between default and

non-default rates and was not viewed as a penalty. See also *In Re: Urban Communicators PCS Limited Partnership v. Gabriel Capital, LLC,* (inaudible - no audio) by the same proposition.

Here, again, each of the debtors is solvent from the debtors' claimed calculations that is, and, although the spread here is quite significant, I would not view it as a penalty. On the other hand, the debtors will not be able to confirm a plan and, in all likelihood, unless they could find additional greater financing, would either have the automatic stay lifted, or go into liquidation mode, or have their case be converted to a Chapter 7 case and, therefore, not receive a fresh start if the default interest here was allowed. In addition, in that event, at least certain of the debtors' unsecured creditors, that is unsecured creditors of certain of the debtors, I believe would not be paid in full based on the evidence before me in connection with the so-called best interest analysis under 1129(A)(7).

The other factor in that list of factors to consider and employ, albeit carefully and sparingly under the case law, is creditor misconduct. And it is an important point made by the debtors that needs to be evaluated. The facts here, as asserted by Brooklyn

Lender, are Brooklyn Lender's assertion of several different types of default. First and foremost, in May of 2017, Brooklyn Lender asserted a default based on Section 18.I of the loan agreements that either the debtor or the debtor's principle, Mr. Strulovitch, had provided a misleading certificate or other information as part of the debtor's loan application with regard to the ownership of the debtors. The default under the loan agreements would apply, or the representations respect of, by the debtors in respect of their loan application, is updated as of the date of the loan. If, in fact, the ownership information was inaccurate, then the default would exist from the commencement of the case.

In addition, Brooklyn Lender has alleged that the debtors violated sections 9 and 18(Q) of the loan agreements by permitting encumbrances on two debtors, 18 Homes, LLC, and 16 -- I'm sorry, 6118 Lafayette LLC, one encumbrance being in the form of a mortgage and the other in the form of an agreement that would declare an impediment to sale. In addition, each of the loan agreements in paragraph 18(I), I misspoke about the paragraph with respect to non-ownership, that's 18(G), 18(I) have as an event of default a bankruptcy filing and the loan agreement provides that

that would constitute and event of default.

Finally, the loan agreements all provide for a stated maturity date for the loan and provide in paragraph 36 that until paid following maturity, those default interest will accrue on the unpaid balance. I will also note that the lender has alleged, finally, defaults based upon uncured building violations on many, if not all, of the properties. I'll address each of these defaults as to whether they actually exist and then as to whether they are enforceable under New York law. Which would apply, obviously, both for the pre and post-petition period, the 506(B) analyses being placed on top of the New York State law analysis.

Let me begin with the bankruptcy default. The debtor in each case here has indisputably been current on making regularly scheduled non-default interest payments, except with respect to the maturity defaults which all occurred post-bankruptcy. The debtor has not missed a payment under the loan, except to the extent that I conclude that default interest is owed on top of regular interest.

In that circumstance, Courts have held, and I agree with the holding, that the non-default rate should apply when the only default was the bankruptcy

filing, itself, and the creditor was paid non-default interest currently. That was the holding in *In Re: Residential Capital*, 508 B.R. at 862, see also *In Re: Boundtree, LLC*, 2009 Bankr. LEXIS 2294 at *11-14 (Bankr. E.D.N.Y. July 24, 2009), and *In Re: Northwest Airlines Corp.*, 2007 Bankr. LEXIS 3919 at *16-18 (Bankr. S.D.N.Y. Nov. 9, 2007).

As far as those two latter cases are concerned, I disagree with Judge Milton's theory that payment at the default rate under such circumstances would be tantamount to enforcing an ipso facto provision. And rather I believe that the correct analysis is that, as Judge Glenn found in *Residential Capital*, there is no basis to call a default where here, as was the case there, there is no real issue of the lender not being paid. In *Northwest Airlines*, Judge Gropper concluded that to the extent there was a default other than the bankruptcy filing, it was not a meaningful default that would require default interest. But the fundamental principle involved there is similar to the holding in *Residential Capital* which is namely a simple bankruptcy default should not trigger default interest where it appears clear that the debtor will be paying the non-default rate currently and ultimately satisfy the claim under the

plan.

Under New York law, as I noted, there are important limitations on a secured creditor which has a mortgage on real properties ability to enforce, including by acceleration, certain defaults. New York law defines loan defaults into two types, basically principle or interest payment defaults, so-called monetary defaults, and everything else so-called non-monetary defaults, absent truly extraordinary circumstances such as lender misconduct or a de minimis delay in making a payment, lenders can accelerate and enforce a borrower's monetary default. See for example, *Small Business Lending Corp. v. Crossways Holding*, 2014 N.Y. Misc. LEXIS 4175 (Sup. Ct. N.Y. Cty. Aug. 29, 2014) and (1) Bergman on New York Mortgage Foreclosures, Section 5.06, 2020.

However, with regard to, again, extraordinary circumstances with regard to payment defaults and nonpayment defaults, the Courts have long recognized an equitable exception to enforcing the parties' contract with respect to calling a default. Generally the Courts look to three factors in making that analysis, has the lender suffered actual damages as a result of the default, has the default impaired the lender's security, that is the collateral securing the

debt, and does the default somehow make the future payment of principle and interest less likely. The Courts also look at whether the default was inadvertent or insignificant. As far as significance, generally they look at the three factors that I first mentioned. See generally *Karas v. Wasserman,* 91 A.D.2d 812 (3d Dep't 1982) and numerous other cases, including *Empire State Building Associates v. Trump Empire State Partners,* 245 A.D.2d 225, 226-28 (1st Dep't 1997), *Bloomgarden v. Tinton 763 Corp.*, 18 A.D.2d 979 (1st Dep't 1963), *Rockaway Park Services Corp. v. Hollis Automotive Corp.,* 206 Misc. 455 (Sup. Ct. N.Y. Cty. 1954), *100 Eighth Avenue Corp. v. Morgenstern,* 4 A.D.2d 754 (2d Dep't 1957), and *Tunnell Publishing Company v. Strauss Communications,* 169 A.D.2d 1031, 1032 (App. Div. 1st Dep't). See also Michael Giusto, "Note: Mortgage Foreclosure for Secondary Breaches: A Practitioner's Guide to Defining 'Security Impairment,'" 26 Cardozo L. Rev. 2563 (May 2005), which discusses not only this general rule, but also how to determine or how one should determine or how the case is addressed, whether a default actually impairs a lender's security or make future payment of the lender less likely or cause actual damages.

I have evaluated each of the defaults alleged

here and in light of the testimony that I've heard and the evidence that's been received applied to that case law. Certain of the defaults I have determined, after hearing the testimony, and I should state the testimony that I have heard, which is of the debtor's principal, Mr. Strulovitch, debtor's manager, Mr. Goldwasser, Mr. Kohn, with respect to how the debtors have addressed building violations, Moses Strulovitch, Joshua Wagschal and Mr. Hutman (phonetic), in addition to Mr. Strulovitch, as to the issue regarding the alleged nondisclosure of ownership interest. The testimony of Mr. Halpern and Schoenberg with regard to the nature of the ownership interest claimed by the Israeli investors. And then also the testimony by Mr. Aviram, the representative of Brooklyn Lender with regards to the actions it has taken with respect to the alleged defaults. Brooklyn Lender's two experts, Ms. Stewart and Mr. Madison laying out the context of how lenders look at defaults, including non-monetary defaults. And finally, Kenneth Stagnari, the loan officer at Signature Bank, that was the officer responsible for the loans on Signature's side before they were transferred to Brooklyn Lender, although not during the entire time that Signature was the lender.

As I said, certain of the defaults here I

believe is relatively easy to determine, should not serve as a basis for actually enforcing a default in addition to the bankruptcy default that I've already mentioned. The easiest one to apply here, the foregoing analysis to, are the various building code violation defaults. The only credible witness on this issue, as well as one who I believe was quite knowledgeable generally, not only with regard to the debtor's loans but real estate, that is commercial real estate lending in the New York area, was Mr. Stagnari who is in charge an extremely large, both in terms of numbers and loan amount, the portfolio at Signature Bank, and came across as a very knowledgeable, credible and reasonable loan officer.

Mr. Stagnari testified that to his knowledge, Signature Bank has never called a non-monetary default, and within that subset has never called the non-monetary default, or building violations, or building code violations. The testimony was also clear that almost every, if not every building in Mr. Stagnari's extensive loan portfolio, has many building code violations on it.

The testimony of Mr. Kohn, and that's spelled K-O-H-N, was also clear that the debtors have successfully addressed and either cured and removed or

reasonably believe that they will have the violation removed because of the cure, albeit that that process, consistent with the process generally in New York City, has taken a considerable amount of time. In light of that, I do not believe that such a default with respect to any of the debtors should trigger default interest, and that instead the debtor did not place Brooklyn Lender at risk in respect of its collateral or ultimate payment with respect to such defaults. That they were not ultimately, therefore, material or were the basis for acceleration and triggering the substantial increase in interest to the 24 percent default interest under the loan agreement.

I believe to the contrary that placing of a mortgage on one of the debtors and an agreement to, in essence, encumber the ability to sell the other debtor did, in fact, in addition to violating paragraphs 9 of the loan agreement and 18(Q), impair the lender's security. And I do not believe, contrary to the testimony of the recipients of those agreements, that, and Mr. Strulovitch, that is namely Mr. Schwimmer and Mr. Greenfield, that those encumbrances were accidental or inadvertent. The actual encumbrances are written and signed by Mr. Strulovitch in each case. It's hard to imagine, therefore, that the

agreements were accidents. They're not lengthy, they specifically refer to these properties, and again, one would have to argue mutual mistakes and that simply didn't happen here.

It is the case that both of those individuals have waived their rights under those agreements and that they are no longer of record on the county records. So today Brooklyn Lender's security is not impaired by them, but it was impaired from the date that they were recorded, and it would be appropriate, therefore, to enforce the default provisions with respect to those two agreements. And, therefore, the default interest would need to accrue from the date of the default in each case against each of those two debtors.

The next default is the debtor's or Mr. Strulovitch's disclosure contended to be inaccurate by Brooklyn Lender that the debtors were owned either 100 percent by Mr. Strulovitch, or in some instances 50 percent by Mr. Strulovitch and 50 percent by another. Brooklyn Lender contends that, in fact, certain debtors were owned in part by third parties, namely four debtors, 325 Franklin, 618 Jefferson, 106 Kingston, and 1213 Lafayette, were owned 45 percent by the Israeli investor LLCs, and only 55 percent by Mr.

Strulovitch. In addition, it is argued that Mr. Wagschal, in addition to owning at least 50 percent of certain debtors, also owned a substantial amount of the Mesemer (phonetic) and Lorimer debtor and that his ultimate ownership, wherever he has an ownership interest, is not 50 percent only as disclosed in some cases as part of a loan application package, but rather close to 100 percent.

The debtors contend that each of those claimed ownership interests are not ownership interests, but rather have described them as profit sharing interests. Each of these debtors is a limited liability company. Limited liability companies under the tax laws record any such interest, i.e. a profit sharing interest, as an ownership interest or a partner interest because they report income and losses as a partnership. So these debtors' owners are issued K-1s that the record reflects generally show the claimed ownership interests by Brooklyn Lender, with the exception of the four debtors with regard to the 45 percent Israeli investor interests.

There does appear to have been operating agreements for those for debtors that contemplated or that provided for those 45 percent interests, and in evaluating the testimony, I conclude that Mr.

Strulovitch's testimony that, in fact, they changed the nature of the interest to a profit sharing interest, they meaning the managers of those entities, those entities' managers being Mr. Strulovitch and a Mr. Oberlander, because the loans wouldn't work without it, might be true. But I do not accept his testimony that Signature Bank knew about this. He was referring to a conversation he had with the former loan officer, Mr. Dietz, ono that point. There's no writing to memorialize it and no disclosure, and I do not accept that that ever happened.

It is also the case that both Mr. Strulovitch and Mr. Wagschal had only the most rudimentary understanding of an ownership interest in an LLC and a profit sharing interest. I conclude that the better view of the facts is that where Brooklyn Lender has contended that a third party, namely Mr. Wagschal, or the investor, Israeli investor LLC, had an ownership interest in a particular debtor, Brooklyn Lender's view is the more likely one and, therefore, that the debtors have not carried their burden of proof with respect to disclaiming the default.

On the other hand, in evaluating the New York case law that I previously summarized, I do not believe this is the type of default that the New York

Courts would enforce. First, it is not entirely clearly that all that was determined here to confer was only a, was an ownership interest as opposed to a profits interest. I reached that conclusion largely because I don't believe that any of the parties really had a clear understanding of the difference. More importantly, I do not see how Brooklyn Lender or Signature Bank's collateral or ability to be repaid was in any way affected by the default to the extent there was a default.

These are loans that are not recourse to the owners. Mr. Strulovitch gave what's only, as a term of art that's described by Mr. Stagnari, a, quote, "bad boy guarantee, not a monetary guarantee, it's clear from his analysis of the loans and Signature Bank's analysis of the loans and the com (phonetic) reports, that signature bank relied upon the income stream of the properties, i.e. rental payments, and/or the value of the properties, themselves, either for refinancing or sale in order to get repaid. But it did not do a credit analysis or look for a balance sheet or other financial disclosure by the other owners besides Mr. Strulovitch that were disclosed to it, including Mr. Wagschal. And even as to Mr. Strulovitch, they did not, according to Mr. Stagnari's

testimony, pay attention to his credit reports. They did require a relatively brief financial statement. I should note that Brooklyn Lender's own representative, Mr. Aviram, found the dramatic increase in value of Mr. Strulovitch's net worth on that financial statement to be on its face incredible, so I conclude that Signature Bank also would have done so and would not have relied on it, in fact, didn't rely on it. This is not a question of a lender being put to a test by a Court to do additional due diligence to see whether a debtor was lying to it, which obviously would not excuse the lie, but rather a lender seeing on its face an incredible disclosure and not taking any action in response to it.

The only possible adverse effect on the lender here from the apparent failure to disclose ownership or even beneficial ownership through an income or profits assignment, that is the potential for violation of the currency laws and regulations, and know your customer rules. In the post argument briefing, the parties have addressed that issue, and I conclude, although it's a complex issue of law that I'm not sure loan officers are aware of, and I do not believe that Mr. Aviram was aware of it or Mr. Dietz, I believe that the regulations do require disclosure

even as someone that would have a profits interest. However, again, that failure to disclose has apparently no bearing, whatsoever, on Brooklyn Lender's being paid in full in respect to this loan or on its collateral. Indeed there's no evidence that upon learning of potential other owners of certain of the debtors or the profits/interest argument, that Brooklyn Lender did any reporting to the government authorities. And there is no suggestion that any of these parties would actually be covered by the rules that came into effect under the Patriot Act.

So ultimately I conclude that under New York law the ownership defaults also would not properly be enforced by the New York Courts. And as I said, I also conclude that the alleged inaccuracies in reporting Mr. Strulovitch's net worth also are not the type of default given their inherent and obvious, obvious inaccuracy in reporting a gigantic net worth, enormous increase from the original proposal and, therefore, could not be something that would serve as a basis to accelerate on or that anyone reasonably relied on.

That leaves one other set of defaults. Each of the loans, as I've noted, has a maturity date. None of the loans matured by their terms before the

bankruptcy petition date, but several of them have since then. And consistent with Judge Glenn's ruling in the *Residential Capital* case and the analysis that I will go through next, I believe that post maturity default interest should be paid and, therefore, would be allowed under the Bankruptcy Code. Certainly, there's no question that under New York law post maturity interest would be allowed, that type of default is a payment default and it does not fit into any of the cases that in extraordinary circumstances relieve a party from a payment default.

The debtors have argued that Brooklyn Lender's own misconduct prevented them from paying the loans off at maturity, and I've considered that argument carefully. Obviously, I viewed Brooklyn Lender's calling the defaults that I've said should not be enforced as tantamount to this conduct under the 506(B) case law, if a Court is not going to enforce such a default under New York law then pursuing it actively is improper. I think that law is well established and the cases go back to the '20s. There are not many recent cases, I think that's because as of the '80s the law was well established.

The debtors, as I've said, have contended that that fact pattern should also excuse them from having

to pay post default interest on the payment default based on the actual maturing of the loans and the loans not being paid at that point. They also argue that the loans were improperly accelerated based on the other defaults and, therefore, it's hard to argue that they separately matured.

I have the following responses to those arguments. First, as to the latter argument, the acceleration would be undone based on my ruling with respect to the, certain of the defaults, including the across the board ones for the alleged inaccurate reporting as part of the loan package. That would mean that the loans are still subject to their original maturity.

Secondly, the misconduct here, if it rises to that level, clearly does not affect the maturity of the loan for two reasons. First, the debtors did not exercise their right to force an extension of the loan which under certain circumstances they have under each of the loan documents. That is a right that is initiated by the debtors and they admittedly did not do that until the plan, itself, was filed.

Secondly, it is not only the case that Brooklyn Lender would not have extended the loans, but also that it would probably, in almost all of the

loans, have the right to do so, or most of the loans, have the right not to extend if there had been a proper request because there were late payments on most of the loans, even if those payments did not rise to the level of a payment default. Even more importantly, however, the debtors have not introduced evidence that they actually had the ability to refinance the matured loans post maturity. To the contrary, the only time they were able to come up with such financing was in connection with the plan with the Lightstone financing. So the misconduct doesn't relate to the ongoing default with respect to not satisfying the loans upon their maturity date. Once that maturity occurred, it appears clear to me that under the case law, both the New York case law and the 506(B) case law that I previously cited, post default interest should apply to those debtors from the maturity date forward.

At the oral argument on this issue, counsel for Brooklyn Lender confirmed that the roughly $3.6 million of post default interest tied to this default only ran from the maturity date. And while the debtor's counsel said that she wanted whether that took into account any payments of principle that should have been applied to principle or not, it

appears clear to me that the Brooklyn Lender is calculating the default from the maturity date as opposed to some earlier time.

So let me further state that Brooklyn Lender submitted two expert witnesses on the default issue, Ms. Stewart, however, proffered almost literally no testimony that was relevant to a set of debtors like these with commercial real estate in New York. Her experience, albeit lengthy and of a responsible nature over her career, has been with consumer loans, loans on residential property, although sometimes property that had a few units within it that would be rented out, considerations with respect to non-monetary defaults and borrower character in that environment are entirely different than with respect to the actual loans at issue here. And I took Mr. Stagnari's testimony to be of far more weight than Ms. Stewart's as to what a reasonable lender would do with respect to the non-monetary defaults asserted here.

Mr. Madison's testimony was brief, but not in any way contradictory to the legal conclusions that I've reached here. He simply noted the importance of a default rate for monetary defaults, and noted that, generally speaking, non-monetary defaults are important, although the Courts have come up with

exceptions to that enforcement.

So it appears to me from the foregoing ruling that the current plan cannot be confirmed based on Brooklyn Lender's having an allowed claim even before considering its claim for attorneys' fees. With respect to those debtors whose loans have matured post-petition and/or, because I think there's some overlap, the two debtors where there was an encumbrance, I've considered carefully whether the fact that the debtor will not be able to confirm a plan in those cases means that the factor that the post-default interest will impair the debtors' fresh start and/or that creditors of those debtors, unsecured creditors, might well not receive a full recovery in light of the foregoing should argue against applying the post-default interest in those cases.

This is not an easy question. Congress clearly favors the reorganization of debtors; however, these are debtors that don't employ many people and the record is not entirely clear as to whether under my ruling unsecured creditors really will be meaningfully impaired here based on my ruling. So given that I am not going to limit the interest rate against, in the claims against those debtors by Brooklyn Lender on

those factors under 506(B) of the Code. And as I said, the creditor misconduct factor really does not apply to either of the instances where I found that post-default interest should lie, because if there is any misconduct in pursuing defaults that shouldn't have been pursued, it doesn't pertain to those two points.

I will note when I refer to misconduct, that I am not generally deviating from the case law that deals with this issue in the context of champerty or unconscionability. The Courts, including specifically a number of Courts in this district, have recognized that the mere fact that a party buys a mortgage note or notes with the knowledge that it will be enforcing a default that it is aware of and that it may have among its motives, a motive to obtain a large profit and/or (indiscernible) the properties that are subject to the mortgage is insufficient to limit the enforceability of the loan under the Bankruptcy Code. See *In Re: Downtown Athletic Club of New York City,* 1998 Bankr. LEXIS 1642 at *25-26, 31-33, 34-35 (Bankr. S.D.N.Y. Dec. 21, 1998). See also *In Re: 139-141 Owners Corp.*, 313 B.R. 369, and *Bank of America National Trust and Savings Association v. Envases Venezolanos, SA,* 740 F.Supp. 260, 269 (S.D.N.Y).

(indiscernible) debtors' request for

confirmation of this plan, since it's a joint plan it would cover those debtors. I think it is worthwhile, however, to deal also with the objection by the Israeli investors to the join plan so that the parties can be guided with respect to any future plan in this case or assertion of rights in this case.

With regard to the Israeli investors, again, it's important to note that there are two sets of Israeli investors and each of those two sets have asserted two different types of claims against the debtors. First, there are the investor LLCs which directly invested in the specific four debtors that I previously identified, 3225 Franklin, 618 Jefferson, 106 Kingston and 1213 Lafayette. Those investor LLCs, with respect to their claims against those four debtors, clearly would fit into the plain language of Section 510(B) of the Bankruptcy Code which, for purposes of distribution under Title 11, would be subordinated to the level of the equity interest in those debtors given that the claim as set forth in the proofs of claim for those investments would be for damages arising from the purchase or sale of a security in the debtor or of an affiliate of the debtor or for reimbursement or contribution on account of such a claim.

In addition, those investor LLCs and other Israeli investor LLCs that have filed proofs of claim, allege that they have claims against all of the debtors on the theory that those debtors participated in a fraudulent scheme by Mr. Oberlander and Mr. Strulovitch to take the investor LLCs' money would was to be dedicated in investing in specific real estate projects, such as the four that I just mentioned, and instead used that money for other projects or other uses. Unless those other, unless the money went to an affiliate of the debtor, such a claim would not be covered by Section 510(B) of the Bankruptcy Code. See, for example, *In Re: Washington Mutual Inc.*, 462 B.R. 137 (Bankr. D. Del. 2011), and *In Re: Semcrude, L.P.*, 436 B.R. 317, 321 (Bankr. D. Del. 2010).

It is quite possible that the allegedly fraudulently transferred funds did go to an affiliate of the debtor given that Strulovitch apparently controls all of the debtors, but that has not been proven by the debtors in connection with confirmation. I will note that Section 1012(B) defines an affiliate as a corporation, and the Courts have applied that to LLCs, 20 percent or more of whose outstanding voting securities are directly or indirectly controlled, or owned, controlled or held with power to vote, by the

debtor or by an entity that directly or indirectly owns, controls, or holds with power to vote, 20 percent or more of the outstanding voting securities of the debtor other than an entity that holds the securities in any capacity that would not be relevant here.

I also tend to agree with the 5th Circuit ruling in *Templeton v. O'Cheskey (In Re: American House Foundation)*, 725 F.3d 143, 155-56 (5th Cir. 2015), that the better view which is not followed by the two Delaware cases that I previously cited, is that if a party seeking to impose 510(B) on a claimant shows sufficient control over the debtor or an affiliate by authority, then 510(B) would apply. The problem here is there is really no proof to show that the allegedly transferred funds or improperly transferred funds went to affiliates, including as defined in the 5th Circuit case. And therefore, as to claims against debtors other than the four that I mentioned, the debtor has not made its case under 510(B).

That's not the end of the story, however, because there is absolutely nothing in the record on any credible basis to show that any such funds actually went to anybody that the debtors participated

in or received. The testimony of the Israeli investors specifically omitted any contention to the contrary. Their proofs of claim, which attach their complaints in pre-bankruptcy litigation on this point, are incredibly vague on the facts, including clearly not satisfying Bankruptcy Rule 7009 as to the elements of fraud, including when these fraudulent events occurred, who the recipients were, and the like. So I've concluded that to the extent that there is a feasibility objection here, the debtors have sustained their burden as to feasibility notwithstanding their inability on this record to establish that the Israeli investors LLC investor claims should be subordinated under Section 510(B) of the code.

The second group of Israeli investors are individuals, including the two who testified, who concededly did not invest in the debtors, but rather invested in the investor LLCs. They are, therefore, either a creditor or a shareholder in the investor LLCs. The 2nd Circuit has been clear that in that fact pattern they would not have a claim against the debtors. They only claim derivatively through the investor LLCs. They are simply, again, an investor in or creditor of a potential creditor of the debtors. And, therefore, are not parties in interest and do not

have a claim against these debtors. See *In Re: Terrestar Networks, Inc.,* 2013 WL 781613 at *1 (Bankr. S.D.N.Y. Feb. 28, 2013). See also *In Re: Refco Inc.,* 505 F.3d 119 (2d Cir. 2007), and *In Re: Comcoach Corp.*, 698 F.3d 571, 574 (2d Cir. 1993).

They face that insurmountable hurdle, in addition, their proofs of claim, like the proofs of claim of the investor LLCs, are incredibly vague and unsupported and inconsistent with Rule 9 and I would not require any reservation or reserve for such a claim given the existence of such claims. But in any event, they don't have a claim because they only claim through a potential claimant and not on behalf of themselves directly.

The Israeli investors raised a number of other objections to confirmation, all of which I dealt with at oral argument and believe don't need to be further addressed. Namely, contrary to the objection it is clear to me that this plan is not a substantive consolidation but merely provides for cross collateralization of the exit loans in a way that's beneficial to these investors just as collateralization is permitted in DIP agreements, which doesn't lead to any sort of substantive consolidation on the debtors.

I've also concluded that with the exception of one debtor that the debtors' counsel has agreed would be separately carved out from the overarching exit loan, namely 106 Kingston, the plan satisfies the best interest test under Section 1129(E)(7) of the code with regard to the Israeli investors for the reasons stated in the transcript of the August 7, 2020, hearing transcript at pages 35, 37 and 38 and 41 through 42.

The plan's classification scheme appeared to me then and appears to me now to be a little off with regard to the Israeli investors. They're all included in class six which are descried at the 510(B) claims. As I've previously ruled, it is conceivable to me, and the debtors have not satisfied their burden of proof to the contrary, that certain of the Israeli investor LLC claims for fraudulent involvement in the taking of their funds and not placing them in its specifically designated investments, are not covered by 510(B) and, therefore, would be unsecured claims that would be included in class four. And, however, it also appears to me that the debtors, themselves, assert that these are profits interest, so conceivably they could be in class five as far as whether the money was meant to be invested in any other debtor.

So again, I've concluded that the claims really don't assert, as far as at least feasibility purposes, an unsecured claim that could be allowed. And again, I have not determined that issue on the merits yet, but certainly before me it does present a feasibility problem. But and also the claims were objected to and, therefore, their votes would not be counted in class four. But they should be included in class four to the extent they don't fit into class six. The transcript reflects that I thought at one point they might be included in class five, and therefore that the debtors would have to satisfy the cram down requirements of class five, with respect to class five, however, I believe it's clear from the record that the debtor would satisfy the cram down requirements under 1129(B)(2)(C)(ii) since no junior class is recovering anything. But having reviewed this with more care, I conclude that the investor LLC claims other than the four, the four entities which I've already outlined which are probably in class six, would not be in class five but rather would be in class four. So in a future case, to the extent that there isn't a claim objection that is granted, that's where they should be placed.

So I, the oral argument I believe also dealt

with all of the other plan objections raised by the Israeli investors and I don't need to repeat that ruling here. I also at that ruling dealt with the Israeli investors' request to appoint a Chapter 11 trustee. There is absolutely no support for that contention in the record and it was not actually pursued, nor was it pursued by Brooklyn Lender who had made a request several months before for similar relief. So that relief, those motions are denied.

I know this is quite a very lengthy ruling and I'm sorry to strain your patience for roughly two hours. I am going to ask the debtors to prepare an order consistent with my ruling which would, again, unless I've just done the math wrong, would require confirmation of the joint plan to be denied for the reasons stated, namely that Brooklyn Lender's claims against certain of the debtors for default interest based on the maturity of the loans, again, by the those debtors, and the two encumbrances permitted by the two debtors, would preclude confirmation of the joint plan. It is conceivable to me that the debtors can pursue confirmation of plans for other debtors and/or that they and Brooklyn Lender might want to negotiate a plan that would provide for payment of Brooklyn Lender and not involve a third party. And

that as far as this plan is concerned, I believe it can't be confirmed on that basis. On the other hand, I have overruled the objections by the Israeli investors, albeit that I've found that the plan improperly omitted their claims potentially as claims in class four, but also found that they did not have a right to vote in class four because their claims were objected to. And that ultimately the plan is feasible, even if their claims were in class four because it appears clear to me, based on at least the record I have to date, that there is no merit to those claims.

I have not addressed Brooklyn Lender's fee claim. I've not done that for two reasons. First, I am sure it's incurred more fees since the time records were submitted. Secondly, I believe the debtors should have the opportunity to review the time and expense records in light of my ruling which, again, reflected that much of the defaults called by Brooklyn Lender really would not be enforceable and, therefore, might reflect on the allowability of the fees related to the attempt to enforce those defaults.

Moreover, it all might be moot given my ruling and I think the parties should step back and reflect upon the potential exit approaches for these cases

going forward. It may well be that some of the debtors can't be reorganized and some can, or it may be that the parties may be able to reach some sort of agreement that would permit an overall approach. Or that the parties on the phone may be able to reach some sort of agreement among themselves with regard to reorganizing some of the debtors.

So I'll ask Mr. Frankel, in addition to preparing the order consistent with my ruling today, to schedule a case conference through Ms. Lee within the next 30 to 45 days where we can talk about the next steps in the case. That could also be a hearing date, if anyone wants to seek relief such as, for example, for relief from the automatic stay or conversion of the case, or the like, or a conversion of cases or the like.

So does anyone have any questions? Is anyone on this phone?

MR. GLENN: No questions on behalf of Brooklyn Lender, Your Honor.

THE COURT: Okay. I just had a horrible thought that I'd been speaking for two hours and the line was dead. All right, so Mr. Frankel, you don't need to settle that order formally on counsel for Brooklyn Lender and counsel for the Israeli investors,

but I do want you to circulate it to them in advance so they can make sure it's consistent with my ruling.

MS. CARUSO: Thank you, Your Honor, for everything.

THE COURT: I just want to make sure you heard that, Mr. Frankel?

MS. CARUSO: Yes, if he didn't hear it, this is Andrea, I heard it and I will make sure that he understands.

MR. FRANKEL: I'm sorry, I was on mute, I heard it.

THE COURT: Okay, very well, so I'll look for that order. Thank you, everyone.

(Whereupon the matter is adjourned.)

I, Carole Ludwig, court approved transcriber, certify that the foregoing is a correct transcript from the official electronic sound recording of the proceedings in the above-entitled matter.

Carole Ludwig

CAROLE LUDWIG December 30, 2020